UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Electricity Market Design and Structure	)	Docket No. RM01-12
Regional Transmission Organizations	)	Docket No. RT01-100
Midwest Independent System Operator	)	Docket No. RT01-87

COMMENTS OF THE EAST TEXAS COOPERATIVES ON ELECTRICITY MARKET DESIGN AND STRUCTURE IN REGIONAL TRANSMISSION ORGANIZATIONS AND IN RESPONSE TO COMMISSION'S INVITATION FOR COMMENTS

East Texas Electric Cooperative, Inc. ("ETEC"), Northeast Texas Electric Cooperative, Inc. ("NTEC"), Sam Rayburn G&T Electric Cooperative, Inc. ("SRG&T") and Tex-La Electric Cooperative of Texas, Inc. ("Tex-La") (collectively, the "East Texas Cooperatives") hereby submit these comments regarding electricity market design and structure regional transmission organizations ("RTOs"). These comments are filed in response to the Commission's *Order Providing Guidance of Continued Procession of RTO Filings* issued on November 7, 2001 in Docket No. RM01-12, and the Commission's *Notice Inviting Comments on Wholesale Market Activities* issued on November 20, 2001 in RM01-12 and several other RTO-related dockets. Following is a summary of the major points made in these comments.

- Even well designed energy markets will stand a good chance of failing unless the RTO is truly independent.

- RTO markets, as well as the RTO tariff, should be standardized, but variation should be permitted in order to accommodate distinctive regional needs and characteristics.

- Regardless of what congestion management model the Commission or an individual RTO adopts, cooperatives must be assured transmission rights sufficient to serve their members.

- All transmission owners, including cooperatives, should have the opportunity to participate in the RTO on equal terms, meaning: 1) there should be one objective test uniformly applied to all participating transmission owners to determine what facilities are transmission, and 2) all transmission owners that turn control of their facilities over to the RTO should be assured of full recovery of their costs.

- The most effective ways to mitigate market power are to: 1) design open, efficient, transparent market structures, and 2) employ a strong, independent market monitor.

- The development of RTOs in the Midwest and Southeast will be impeded as long as SPP and its members remain outside of a FERC-approved RTO.

I. INTRODUCTION

ETEC is a non-profit generation and transmission electric cooperative organized in 1987 under the laws of the State of Texas. ETEC does not borrow funds from the Rural Utilities Service ("RUS") and, consequently, is regulated by FERC. ETEC's three Texas-based generation and transmission members – NTEC, SRG&T, and Tex-La – each purchases from ETEC a portion of its power requirements for load currently located within the SPP and SERC reliability areas. NTEC, SRG&T and Tex-La are RUS borrowers and are therefore exempt from the Commission's regulation. *See, e.g.*, *Dairyland Power Coop.*, 37 FPC 12 (1967), *aff'd sub nom.*, *Salt River Agricultural Improvement and Power District v. FPC*, 391 F.2d 470 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 857 (1968).

The East Texas Cooperatives strongly support the establishment of independent RTOs because of the potential they provide to facilitate nondiscriminatory transmission access over large geographic regions of the country. Since Order No. 2000 was issued in late 1999, the creation of RTOs has proceeded in fits and starts. Several proposed RTOs have emerged and are in various stages of development. However, despite the significant

investment of time and money, it appears that RTO operations in most parts of the country will be delayed for at least several months.

On July 12, the Commission jump-started the RTO process by stating its desire to see four RTOs within the United States, and by initiating mediation aimed at producing plans for single RTOs for the Northeast and Southeast regions of the country. The Commission has initiated this rulemaking in Docket No. RM01-12 to address market design and functions and has invited comments on wholesale market activities.[1] The East Texas Cooperatives support the Commission's proactive role in the creation of RTOs, and endorse the standardization of RTO markets and functions through the proposed rulemaking.

II. DISCUSSION

A. Issues Addressed During RTO Week

Although Docket No. RM01-12 is technically limited to the eight RTO functions set forth in Order No. 2000, comments by the panelists and the Commission during RTO Week covered a wide range of topics. Any discussion of RTO markets must begin with the core characteristic that will ultimately decide the success or failure of the Commission's RTO initiatives: independence. Simply put, even if well-structured, standardized energy markets emerge from this rulemaking process, those markets would be at considerable risk of failure unless the RTO is independent, in actuality and in appearance, from all market participants. Insuring the independence of the RTO, therefore, should be the first priority of the Commission.

[1] These comments are being submitted in Docket No. RM01-12-000. In addition, they are submitted in Docket No. RT01-100 and Docket No. RT01-87. The East Texas Cooperatives currently are members of the Southwest Power Pool. The SPP and the Midwest ISO have announced a plan to consolidate their functions. Thus, the East Texas Cooperatives have an interest in the Midwest ISO proceeding (RT01-87). SRG&T intends to join the Entergy Transco, which has announced its intent to join SeTrans (RT01-100).

Several of the panelists during RTO week addressed the importance of cooperative participation in the emerging RTOs. As discussed more fully below, the facilities owned by cooperatives provide benefits to, and are a part of, the interconnected and integrated regional transmission systems being transferred to RTOs. The inclusion of these systems in RTOs is essential to achieving the Commission's goal of seamless markets. Certain cooperatives participating in ongoing RTO discussions, including the East Texas Cooperatives, in the control area of AEP, have met strong resistance to sharing revenues earned under RTO tariffs. They have been told by the large market-dominant transmission owner in the region that any revenue sharing will necessarily result in an unacceptable cost shifts (*i.e.*, decrease in the transmission revenues of the large transmission owners).[2] Transmission-owning cooperatives are unlikely to join an RTO if they are denied the right to share the revenue earned by the RTO, and RUS borrowers are unlikely to obtain the regulatory approvals required under RUS security agreements and regulations if they are not adequately compensated by the RTO for their facilities.

The East Texas Cooperatives will discuss the issues to be addressed in the Commission's rulemaking in the order in which they were addressed during RTO Week.

[2] Providing a revenue allocation to small transmission owners for the use of their transmission facilities would not necessarily result in significant lost revenue by large participating owners. When a small owner elects to join an RTO and transfers control of its facilities to the RTO, the number of transactions possible over RTO facilities increases, as does revenue to the RTO and the overall revenue requirement of transmission owners in the RTO. Because the RTO, and its existing members, would not be receiving revenue for transactions using the small owner's facilities if the small owner did transfer facilities to the RTO, any net loss of revenue to the existing members should be minimal. Finally, the impact of lost revenues on the ultimate consumer should govern these issues, not the impact on individual transmission owners. *See PJM Interconnection, L.L.C.*, 96 FERC ¶ 61,060 at 61,225 (2001) (Wood, dissenting in part). In *PJM Interconnection*, Chairman Wood suggested that a total retail customer bill shift of 3% should be used as a guideline for whether deferral of full implementation of RTO-wide rates is necessary. *Id*. If the total retail customer bill shift is greater than 3%, then use of a transitional pricing device, such as license plate rates, might be necessary. *Id*. No such device would be used if the retail customer bill shift is smaller than 3% *Id*.

1. RTO Markets and Design: Required and Optional RTO Markets

The core function of an RTO is transmission service. However, it is reasonable to expect RTOs to operate a real-time energy market and ancillary services markets as a complement to that core function. As RTOs develop and their roles become better defined, market participants will demand additional services and, hopefully, RTOs will respond. Market participants, however, should not be required to participate in these markets. Users of the transmission system should be able to enter into bilateral contracts and participate in a day-ahead energy market. Market participants should also have the option of self-supplying ancillary services.

It would be unwise for the Commission to adopt a one-size-fits-all view of market design. Clearly, PJM has the most fully developed RTO model at this time. However, other regions have important distinctive characteristics that would make the centralized PJM market design less effective. Further, as witnessed by the recently announced Pennsylvania PUC investigation into possible wholesale market manipulations, there continues to be misuse of market power in the PJM region. *See, e.g.*, "Pa. to Probe Market Power Exercise in PJM," Megawatt Daily, December 3, 2001.

Given the delays in forming functioning RTOs, standard market designs are desirable in the short-term, but ideally variations in market design should be permitted to accommodate distinctive regional needs.

2. Congestion Management and Transmission Rights

The East Texas Cooperatives do not take a position on whether point-to-point firm transmission rights ("FTRs") or flowgate rights ("FGRs") are preferable. Regardless of which model the RTO adopts, entities such as generation and transmission

cooperatives must be assured transmission rights sufficient to protect their load serving distribution cooperative members. Cooperatives should not have to participate in auctions for transmission rights to serve their members. Finally, the only real solution to congestion is a transmission planning process that minimizes the economic impact of congestion charges, which can be prohibitively high, especially to smaller systems.

3. Standardizing RTO Tariffs

The East Texas Cooperatives support a standardized *pro forma* RTO tariff. A standardized RTO tariff will facilitate the formation of RTOs and will create more opportunities for inter-RTO transfers. As stated earlier, there are regional differences that may necessitate variations from a *pro forma* tariff. Nevertheless, the need for some regional flexibility does not argue against the establishment of a *pro forma* tariff. Regional differences were recognized and accommodated in Order No. 888.[3] Similarly, in the instant rulemaking, the Commission should adopt a *pro forma* RTO tariff, but should give individual RTOs the ability to propose changes to the tariff in order to accommodate regional differences.

All transmission service, including service needed for wholesale and bundled retail load, should be taken under the RTO tariff. However, RTOs must also honor grandfathered contracts. The Commission's policies recognize the importance of

[3] *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,734 (1996) ("[I]n response to concerns raised by certain commenters, the tariff provides for certain deviations where it can be demonstrated that unique practices in a geographic region require modifications to the Final Rule pro forma tariff provisions."), *on rehearing*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), *on further rehearing*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *on further rehearing*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom.* Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *cert. granted*, 149 L. Ed. 2d 102, and *cert. granted*, 121 S. Ct. 1185, and *cert. denied*, 149 L. Ed. 2d 105 (2001).

protecting the agreements reached by parties prior to the advent of RTOs.[4] If an RTO is given the responsibility to administer a grandfathered agreement, the contractual rights and obligations should remain intact.

4. RTO Facilities, Cost Recovery and Cost Shifting

In order to maximize the benefits of regional transmission service, RTOs should control as many facilities located within the region as possible. The presence of isolated pockets of non-participating systems will perpetuate pancaked rates and will impede truly competitive markets. All transmission owners should have the opportunity to participate in the RTO on equal terms. This means that: 1) there should be one test, uniformly applied to all participating transmission owners, to determine what facilities are transmission; and 2) all transmission owners that turn control of their facilities over to the RTO should be assured of full cost recovery. An RTO that does not adequately address these issues will have a very difficult time attracting the participation of public power.

An objective, straightforward test to determine what facilities are transmission should be devised and applied to all transmission owners that seek to turn control of their facilities over to the RTO. Several parties have suggested that a functional test, based on Order No. 888's "seven-factor" test, should be employed. The East Texas Cooperatives believe this approach is misguided. The seven-factor test (or any other functional test, for that matter) would be far too subjective. Using a functional test to determine what

[4] *Regional Transmission Organizations*, Order No. 2000, FERC Stats. and Regs. ¶ 31,089 at 31,205 (1999) (recognizing that transmission contracts entered into prior to the issuance of Order No. 2000 represent negotiated rights and obligations achieved through mutual negotiation, and stating the Commission's goal in reviewing existing transmission contracts to "balance the desire to honor existing contractual arrangements with the need for a uniform approach for transmission pricing and the elimination of pancaked rates."), *order on reh'g*, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (2000), *petitions on review pending sub nom.*, Public Utility District No. 1 of Snohomish County, Washington v. FERC, Nos. 00-1174, et al. (D.C. Cir.).

facilities should be considered transmission would likely result in costly, time-consuming negotiations between cooperatives and RTOs, and could ultimately forestall the participation of public power in RTOs.

The East Texas Cooperatives urge the adoption of a bright-line voltage test. Under such a test, all facilities rated at 40kV or above, as proposed by SeTrans for example, would be considered transmission for purposes of RTO participation. A bright-line test would facilitate the speedy categorization of facilities, and would avoid the uncertainty and conflict that would likely result from the use of a functional test. If a bright-line test is adopted, it should be standardized across all RTOs so that all transmission owners will be able to easily determine which of their assets would qualify for inclusion in an RTO.

Further, cooperatives and other non-jurisdictional transmission owners must be assured of full cost recovery just like any other transmission owner. This is an issue of fundamental fairness: if the IOUs participating in an RTO can recover their full costs, then the same should apply to non-jurisdictional utilities.

To date, none of the RTO proposals have adequately addressed the issue of cost recovery for non-jurisdictional utilities. Most of the proposals, including the proposal by the Southwest Power Pool, have raised the specter of cost shifting in an effort to justify delaying full revenue requirement recovery for non-jurisdictional utilities. Although full cost recovery from Day 1 would be preferred, the East Texas Cooperatives recognize that cost shifting is a major concern for transmission owners and transmission customers alike. In response to this concern, the East Texas Cooperatives have signaled their willingness to accept a compromise whereby if a non-jurisdictional utility system

establishes that the impact on total customer bills of providing the utility with full recovery is less than three percent, the RTO should be required to allow full revenue recovery from Day 1. If, however, the impact is three percent or greater, the revenue recovery for that non-jurisdictional utility could be phased in over three years. This approach, endorsed by Chairman Wood in his partial dissent in *PJM Interconnection* (*see supra* note 1), would preclude the occurrence of large cost shifts, but would allow non-jurisdictional utilities to recover their costs immediately if the potential cost shifts are minor. This compromise would also provide certainty for non-jurisdictional transmission owners: they would know that full cost recovery could be delayed for no more than three years.

Although it is possible to forge a compromise whereby full cost recovery for cooperatives facilities is delayed for some period of time in order to mitigate possible cost shifts, the East Texas Cooperatives strongly contend that it unacceptable for RTOs to make no provision whatsoever for the recovery of costs by non-jurisdictional utilities. It is equally unacceptable to delay recovery of costs for an extended period of time without good reason.

5. Standardizing Markets, Business and Other Practices

The East Texas Cooperatives support the standardization of both basic market design and business practice standards for the markets operated by the RTO. Standardization will give market participants the certainty they need to invest in and actively participate in the energy markets. Standardization will also go a long way towards resolving seams issues between RTOs. Some flexibility should be allowed so that RTOs can address regional idiosyncrasies, but the basic market design and business

practice standards should be developed and standardized by the Commission through this rulemaking process.

6. Market Monitoring and Mitigation of Market Power

Market power and other anticompetitive behavior on the part of market participants is the greatest danger posed by the opening of electricity markets. If market power cannot be effectively controlled, it could offset the benefits most observers anticipate will result from competitive energy markets. The most effective ways to mitigate market power are to: 1) design open, efficient, transparent market structures in the first place, and 2) employ a strong, independent market monitor.

Designing market structures that will resist the exercise of market power is the most effective way of providing before-the-fact market power mitigation. In general, markets should be designed so that no barriers to participation exist. Markets should also be as transparent as possible so that market participants receive accurate price signals. Demand-side participation in the markets is a particularly important way to mitigate market power. Therefore, effective price-responsive load programs should be incorporated into the market designs.

A strong market monitor will be the main vehicle for combating market power once the markets are operational. The market monitor should be independent of all market participants. The market monitor should also be independent of the RTO itself, especially if the RTO is a transco. The RTO should communicate and work with the market monitor, but the RTO should have no control over how the market monitor does its job.

The market monitor should play a role in identifying structural problems in the energy markets that facilitate the exercise of market power or other anticompetitive behavior. The market monitor should also be on the lookout for market participants who are breaking the rules. Once anticompetitive behavior has been confirmed, the market monitor should have the ability take punitive action against the offending party. If the Commission concludes that enforcement power is not within the market monitor's authority, then a procedure should be set up whereby the market monitor reports findings of anticompetitive behavior to FERC and the state commissions who can then take punitive measures. Regardless of which entity has the enforcement power, the market monitoring process should have a punitive component in case the exercise of market power or other types of anticompetitive behavior are discovered. The market monitor would do little to mitigate market power if it could collect and process information on the markets, but had no way to punish market participants engaging in anticompetitive behavior.

B. Participation by SPP in an RTO for the Midwest

SPP represents a major portion of the wholesale electric market in the Southwest. Initially, SPP proposed its own RTO, but that proposal was rejected by the Commission. *See* Southwest Power Pool, Inc., 96 FERC ¶ 61,062 (2001). SPP was then directed to participate in the Southeast RTO mediation, but it did not agree to participate in either of the RTO platforms that emerged from that mediation. *See* Mediation Report for the Southeast RTO, 96 FERC ¶ 63,036 at 65,179 (2001). Now, SPP proposes to consolidate its facilities with Midwest ISO and participate in an RTO for the Midwest region. *See*

Press Release, "Southwest Power Pool and Midwest ISO Reach Agreement on Consolidated Structure" (October 19, 2001).

The uncertainty over what SPP and its members, including AEP, will elect to do with regard to RTO participation threatens to impede RTO development in both the Midwest and the Southeast. The Commission should direct SPP and all of its current public utility members to make a decision on what region and what RTO platform they will participate in as soon as possible. The Commission should ensure that these transmission owners participate in the RTO that encompasses the most natural wholesale market, rather than in the RTO with the most attractive business structure. If the proposed consolidation between SPP and the Midwest ISO takes place, the Commission must ensure that a truly seamless wholesale market exists within the resulting entity, and that, in all other respects, it is in conformance with Order No. 2000.

III. CONCLUSION

The East Texas Cooperatives urge the Commission to continue playing an active role in encouraging the development of RTOs, and in creating energy market structures and rules that will facilitate the participation of public power in RTOs.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 7th day of December, 2001, served the foregoing document upon the parties identified on the Commission's official service list by depositing copies thereof in the United States mail, first class, postage prepaid.

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Michael K. Lavanga